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DEPARTMENT OF NATURAL RESOURCES
OFFICE OF MINERAL RESOURCES
STATE MINERAL BOARD
May 28, 1997

Mr. David Guzy
Building 85
Rules and Publications
Denver Federal Center
Lakewood, CO 80215

Dear Mr. Guzy:

The State of Louisiana receives significant amounts of Federal royalties from lands located in the OCS 8g zone. Therefore, regulations affecting Federal royalties also impact the State of Louisiana.

The Minerals Management Service (the MMS) has proposed regulations that will significantly alter the way in which value is determined in situations in which oil is sold at less than arm's length.

The Louisiana Department of Natural Resources (DNR), through its ongoing field audit program, has noticed that since about 1987, significant bonuses have been paid above posted prices for oil sold in most arm's length (AL) transactions. The State has also noticed that in the vast majority of sales at less than arm's length (NAL), no bonuses above posted field prices were reported. The current Federal regulations place a high degree of reliance on posted field prices or comparables in the field or area for use in determining value in situations where the oil is disposed of at NAL. Due to the fact that bonuses are commonly paid in AL transactions and the current Federal regulations make it difficult to capture true market value in NAL transactions in a timely manner (the MMS must audit arm's length transactions years down the line to determine presence of bonuses above posted prices in order to calculate value for NAL transactions), DNR supports a methodology that captures market value on a timely basis for use by NAL sellers but still allows lessees, who sell their oil AL, to value royalty based on the gross proceeds received by them.

The valuation basis chosen by the MMS for NAL sales begins with the NYMEX (determined at Cushing, Oklahoma) price and backs up to the lease by allowing a difference in spot prices between Cushing and "Market Centers" (such as St. James, Empire, Midland, and

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Guernsey) to which the oil flows (either physically or on paper) and further allows a differential between the lease production's aggregation point and that market center as determined by either an actual exchange differential, actual physical movement costs, or a rate to be published by MMS if the oil flows to a refinery or if it is otherwise disposed of in a manner in which it cannot be tracked to a market center.

DNR believes that a simpler method, at least for Gulf coast oil, could be used. Instead of reliance on the NYMEX price, we believe that local spot prices, as published by a reputable publication, could alleviate the step of adjusting the NYMEX price by the market center differential, vis-a-vis Cushing. DNR is under the impression that either method, over time, may yield similar results. Therefore, if results are similar, this office would support a method that will be less complicated and less prone to error and will require one less computation. DNR is also of the opinion that the regulation as currently written, puts too many legitimate third party AL sellers on index, as opposed to letting them remain on gross proceeds.

Regarding the "crude oil call" provision, DNR believes that only exercised calls, at strike prices, should be subject to indexing on a property-by-property or contract-by-contract basis. That is, if the former owner of a property retains first call on a property's production and the price is set at his or someone's else's posting, with the current lessee unable to solicit bids from other parties, then the royalty value of that oil should be indexed.

Regarding the provision that prohibits lessees from remaining on gross proceeds if they purchase oil anywhere in the country, we feel that provision is far too restrictive. Lessees commonly purchase oil for lease operations and occasionally purchase oil for other purposes, such as making up for production shortfalls or blending light oil with heavier lease production to facilitate transportation. DNR recommends letting lessees remain on gross proceeds (if otherwise qualifying) if they purchase oil for lease operations and setting a limit on how much other oil they may purchase and still be a gross proceeds payor, factoring in matters such as historical volumes purchased, whether the lessee is actively engaged in purchasing, aggregating, and reselling for a profit, and other relevant matters.

Also, MMS has proposed putting on index those payors who buy oil from parties they sell oil to, citing a chance that both deals may be at less than market value, with royalty being underpaid but both parties being "kept whole". DNR supports this provision and believes it should be expanded to include not only reciprocal dealings with oil, but with natural gas and NGLs as well.

DNR also supports MMS's efforts to gather data via their proposed form 4415, which will enable lessees who do not flow oil from the lease production aggregation point to a market center, either on paper or physically, to come up with a location/quality differential which they otherwise

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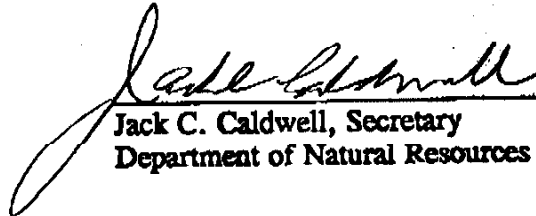
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would not have access to. DNR does believe that some information requested is unnecessary, such as Federal lease number(s) and information requested from operators on fee lands.

To sum up, DNR is supportive of MMS's attempt to value NAL production in a more certain, timely, and accurate manner than provided for in the current regulations. DNR is also supportive of a rule that allows true, legitimate sellers of oil at arm's length to remain on gross proceeds. With the changes suggested in this response, we feel that both goals can be accomplished.

Sincerely,



Jack C. Caldwell, Secretary
Department of Natural Resources